In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 731

NATIONAL LEAD COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The Tax Court's findings of fact and opinion (R. 85–118)[1] are reported at 40 T.C. 282. The opinion of the court of appeals (Pet. 1a–7a) is reported at 336 F. 2d 134.

JURISDICTION

The judgment of the court of appeals was entered on September 1, 1964. The petition for a writ of certiorari was filed on November 30, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED

1. Whether an alleged sale of stock of a British corporation in 1937 from the taxpayer to its wholly owned

[1] Record references are to the petitioner's appendix in the court of appeals.

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subsidiary lacked economic substance and should be disregarded for tax purposes, with the result that the taxpayer is not entitled to a currency loss deduction in 1952 allegedly incurred upon the receipt of depreciated British currency in purported settlement of the 1937 sales price.

2. If the alleged sale of the British stock in 1937 by the taxpayer to its subsidiary is not recognized for tax purposes, whether dividends paid in 1952 by the British corporation upon its stock to the taxpayer's subsidiary, and gain realized in 1951 and 1952 from the sale of the stock by the subsidiary to others, belong to the taxpayer and are includible in the taxpayer's income for those years.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
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> (26 U.S.C. 1952 ed., Sec. 22)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

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(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

STATEMENT

In 1937 the taxpayer sold certain shares of the Goodlass Wall and Lead Industries, Ltd., a British corporation, to its wholly owned subsidiary, a British corporation named Hoyt Metal Company of Great Britain, Ltd. The sale was made at the taxpayer's instigation and was primarily intended to secure a capital loss to the taxpayer for that year which would offset capital gains on the sale of other stock. The sale price was the then current market value of the Goodlass shares on the London Stock Exchange and amounted to £257,884, which, at the 1937 prevailing rate of exchange, was $1,288,938.56. Hoyt set up the purchase price on its books as a sterling debt to the taxpayer, while the taxpayer treated it as a dollar account receivable. At the time Hoyt lacked sufficient resources to pay for the shares. The taxpayer claimed a loss on the sale on its 1937 tax return of $389,031.19, which the Commissioner allowed. It is not disputed that such a deduction would not have been allowed under current decisions. (Pet. 2a–3a.)

For the next fourteen years Hoyt held the stock in its own portfolio and received substantial dividends from Goodlass. During most of those years Hoyt declared and paid dividends to the taxpayer, although the amount of those dividends bore no particular relation to the dividends Hoyt received on the Goodlass shares. During the same period Hoyt's annual earnings varied between £6,200 and £29,300, and Hoyt made no substantial reduction in the debt. (Pet. 3a.)

During 1952 the taxpayer purchased for its own account in London British bonds in the sum of over £228,612—the remaining balance of Hoyt's sterling indebtedness to it. In the same period Hoyt sold on the London Exchange 243,350 shares of Goodlass stock (which comprised only part of the Goodlass shares held by it) for a total consideration of over £228,707 and remitted nearly all of the proceeds from the sale to the taxpayer's account in a London bank, thereby satisfying its outstanding debt to the taxpayer. Hoyt made these sales in order to afford its parent the sterling necessary to pay for the bonds. In other words, like the 1937 transaction, the 1952 sale was at the taxpayer's instigation and request and in furtherance of the taxpayer's own corporate purposes. After purchasing the British bonds the taxpayer exchanged them for West German Deutsche marks which it used to enable another wholly owned subsidiary to purchase full stock ownership of a German manufacturing concern. (Pet. 3a–4a.)

At the time of the 1952 transaction, the equivalent of the sterling debt was $585,068.29, by virtue of the devaluation of the pound. The taxpayer claimed the

difference between this figure and $1,153,823.93—*i.e.*, $568,755.64—as an ordinary loss. The Commissioner disallowed the claim. (Pet. 4a.)

At the same time, the Commissioner determined that the taxpayer realized gain in 1951 and 1952 on Hoyt's disposition on the open market of 283,350 additional shares of Goodlass stock. The Commissioner also charged the taxpayer with income from dividends paid in 1952 by Goodlass to Hoyt. These adjustments were made by the Commissioner on the theory that, as the 1937 transaction should be disregarded for tax purposes, ownership of the Goodlass stock never left the taxpayer. (Pet. 4a.) Finally, in 1956, Hoyt declared a dividend to the taxpayer of approximately £283,900 in purported payment of which it transferred to the taxpayer all of the remaining shares of Goodlass stock held by it, having a fair market value in 1956 of approximately £1,300,000. (R. 94–95.)

The Tax Court (R. 105–118) and the court of appeals (Pet. 4a–7a) disallowed the currency loss claimed by the taxpayer for 1952. Both courts also included in the taxpayer's income in 1952 the dividends received by Hoyt on the Goodlass stock and in its income for 1951 and 1952 the gains derived by Hoyt from the sale of Goodlass stock to others.

ARGUMENT

1. It is well-settled that a claimed loss from a sale is not deductible unless the sale is genuine, that a transfer of legal title from one taxpayer to another without an accompanying shift of control over the property and relinquishment of the economic benefits

of ownership is not a true sale for tax purposes, and that where the alleged sale is between related parties (here a parent and its wholly owned and controlled subsidiary), the transaction must be specially scrutinized to determine whether it is in fact what, in form, it purports to be. *Higgins* v. *Smith,* 308 U.S. 473; *Crown Cork International Corp.* v. *Commissioner,* 4 T.C. 19, affirmed *per curiam,* 149 F. 2d 968 (C.A. 3d); *Bank of America National Trust & Savings Assn.* v. *Commissioner,* 15 T.C. 544, affirmed *per curiam,* 193 F. 2d 178 (C.A. 9th).

Applying these principles, and considering all relevant circumstances, the courts below correctly concluded that the taxpayer's alleged "sale" of the Goodlass stock to its subsidiary in 1937 was without economic substance and that the 1952 loss which allegedly stemmed from that "sale" was not allowable as a deduction. These conclusions have solid evidentiary support. In view of the terms of the "sale" and the financial condition of the subsidiary, it is evident that the transaction is not one which would have been made at arm's length. The taxpayer admits that the sole purpose of the 1937 transaction was to enable it to claim a tax loss as an offset to gains from other transactions; the subsidiary's income and assets were insufficient to enable it to pay for the stock at the time of the sale or for a long period thereafter; the taxpayer carried the selling price on its books as an open account, without any definite due date and without any interest being charged on the debt; the account was permitted to remain dormant for a long period of time; the eventual "repay-

ment" was made solely to facilitate the parent's financing of another transaction with third parties (*i.e.*, to acquire control of a German company); and the taxpayer continued to receive economic benefits from the Goodlass stock for four more years and ultimately (1956) was restored to possession of all the remaining shares.[2]

The same considerations also support the conclusion that the 1937 transaction lacked substance, not only as a "sale," but even as a contribution to the capital of the subsidiary, and therefore that the taxpayer remained taxable upon the income (both dividends and capital gains) derived from the Goodlass stock. See *Commissioner* v. *Smith*, 136 F. 2d 556 (C.A. 2d); *O'Neill* v. *Commissioner*, 170 F. 2d 596, 597–598 (C.A. 2d). We do not suggest, of course, and the court of appeals did not hold, that whenever property is transferred by a parent to its wholly owned subsidiary, the parent should continue to be treated as the owner because of the control inherent in its ownership of the subsidiary's stock. The holding below was confined to the special facts of this case, where the Goodlass shares were "transferred" solely for the parent's tax purposes, where some of those shares were sold by the subsidiary on cue from the parent and solely to provide it with immediately needed funds, and where the remaining shares were ultimately retransferred to the parent. In these special circumstances, the courts below were justified in concluding that the tax-

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[2] In further support of its conclusion, the court of appeals demonstrated (Pet. 5a) that in reality the taxpayer realized a profit rather than a loss from the transaction.

payer not only retained, but actually exercised, continuing control over the property and thus should be deemed its owner. At any rate, the reasonableness of this judgment presents no question of general importance warranting the intervention of this Court.

2. The taxpayer contends (Pet. 7–12) that the principle of *Higgins* v. *Smith, supra*—which would plainly have barred a loss deduction in 1937—should not be extended to deny a deduction in 1952 based upon a review of the 1937 transaction, and that the decision in this case will enable the government to reopen long-established relationships. We submit, however, that the erroneous allowance of a loss in 1937 does not prevent the Commissioner from re-examining the original transaction in order to consider the propriety of the further loss deduction claimed in 1952.[3] The decision below does not reopen the 1937 transaction insofar as the loss claimed in that year is concerned. It merely takes into account "such facts with relation to the taxes for other years" as were necessary to determine the tax liability for the years in dispute. Section 6214(b) of the Internal Revenue Code of 1954 (26 U.S.C. 1958 ed., Sec. 6214(b)).

3. The taxpayer is hardly in a position to complain (Pet. 12–13) that the decision below may have international double tax consequences. If this be so, those consequences will flow from the form in which the

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[3] See *Automobile Club* v. *Commissioner*, 353 U.S. 180; *Niles Bement Pond Co.* v. *United States*, 281 U.S. 357, 361–362; *Springfield Street Railway Co.* v. *United States*, 312 F. 2d 754, 757–758 (Ct. Cl.). On the facts of this case, the taxpayer's reliance (Pet. 8–12) upon *Rothensies* v. *Electric Battery Co.*, 329 U.S. 296, is misplaced.

taxpayer chose to mold this transaction. In any event, the taxpayer has not shown that it could not have obtained relief under the dividend credit provisions of the taxing statute (*e.g.*, Section 902 of the 1954 Code (26 U.S.C. 1958 ed., Sec. 902)) or its predecessor provisions under the 1939 Code). Further, the question of international double taxation would become moot in 1956 when Hoyt transferred all of its remaining shares of Goodlass stock to the taxpayer.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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